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IN THE

Supreme Court of the United States

October Term, 1955

No. 705

NORVIN RIESER, MILTON S. KOBLITZ, GEORGE S. CHAMPLIN, E. M. DART MFG. CO., LILLIAN BOEHM, BERNARD FEIN, KATHRYN P. BRAITHWAITE and EDWARD F. QUIRKE,

Petitioners;

and

EMANUEL JOSEPHSON, RUBIN SLAVSKY, RAYMOND WILEY and WILLIAM W. LANGE,

Intervening Petitioners,

against

THE BALTIMORE & OHIO RAILROAD COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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The petitioners, Norvin Rieser, Milton S. Koblitz, George S. Champlin, E. M. Dart Mfg. Co., Lillian Boehm, Bernard Fein, Kathryn P. Braithwaite and Edward F. Quirke, and the intervening petitioners, Emanuel Josephson, Rubin Slavsky, Raymond Wiley and William W. Lange, bondholders of The Alton Railroad Company (hereinafter termed "Alton"), respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit made and entered herein December 2, 1955 (54-59),* affirming sum-

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* Numbers in parentheses refer to pages in the certified record of proceedings in the Court of Appeals.

mary judgment dismissing the complaint granted by the United States District Court for the Southern District of New York (Murphy, *J.*) and reported at 123 F. Supp. 44 (23-41). The decision of the Court of Appeals, not yet officially reported, appears at pages 21-26 hereof, as an Appendix.

Jurisdiction

The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254(1). The basis for federal jurisdiction in the court of first instance was diversity of citizenship (Title 28, United States Code, § 1332).

Questions Presented

This is a creditors' suit against the respondent (B. & O.) in aid of the equivalents of judgment and unsatisfied execution secured by petitioners against Alton. The Court of Appeals held (Appendix, p. 23) that such creditors' suit is "derivative, in effect", that petitioners "stand in Alton's shoes; they have no shoes of their own", and that, therefore, the creditor-petitioners were barred by virtue of the New York short statutes of limitation (N. Y. C. P. A. §§ 48, 49) affecting Alton and, necessarily, would be precluded by virtue of any other defense that could be interposed to any action by Alton. The Court so held in the face of controlling New York decisions clearly holding that such creditors' suit is independent, and not derivative; that no cause of action accrues to the creditor and no statute of limitations begins to operate against him until the return of execution *nulla bona* against the principal debtor, and that only the ten-year statute (N. Y. C. P. A. § 53) is applicable to such creditors' suits. Therefore, the questions presented are:

1. Did the Court of Appeals erroneously disregard and refuse to apply controlling New York law in holding that this creditors' suit in aid of execution was "derivative, in

effect", and was therefore barred when New York statutes of limitation would have barred action by petitioner's principal debtor (Alton)?

2. In so holding, did the Court of Appeals violate the mandate of this Court in *Erie R. Co.* v. *Tompkins,* 304 U. S. 64, and subsequent decisions, that in diversity cases the Constitution of the United States requires the Federal courts to apply State law?

3. When this action, jurisdictionally based on diversity of citizenship, was begun, was prosecution of petitioners' claims set forth in the complaint herein barred by New York statutes of limitation?

Statutes Involved

Art. 2, § 11, New York Civil Practice Act:

"Mode of computing periods of limitation.

The periods of limitation prescribed by this article, except as otherwise specially prescribed therein, must be computed from the time of the accruing of the right to relief by action, special proceeding, defense or otherwise, as the case requires, to the time when the claim to that relief is actually interposed by the party as a plaintiff or a defendant in the particular action or special proceeding. * * *"

Art. 2, § 48, New York Civil Practice Act:

"The following actions must be commenced within six years after the cause of action has accrued:

* * *

8. An action, legal or equitable, by or on behalf of a corporation against a director, officer or stockholder, or a former director, officer or stockholder, if such action is for an accounting, or to procure

judgment on the ground of fraud, or to recover a penalty or forfeiture imposed or to enforce a liability created by common law or by statute unless such action is one to recover damages for waste or for an injury to property or for an accounting in connection therewith in which case such action shall be subject to the provisions of subdivision seven of section forty-nine."

Art. 2, § 49, New York Civil Practice Act:

"The following actions must be commenced within three years after the cause of action has accrued:

* * *

7. An action to recover damages for an injury to property, except in the case where a different period is expressly prescribed in this article."

Art. 2, § 53, New York Civil Practice Act:

"An action, the limitation of which is not specifically prescribed in this article, must be commenced within ten years after the cause of action accrues."

§ 11 of the Bankruptcy Act (11 U. S. C. § 29):

"(e) A receiver or trustee may, within two years subsequent to the date of adjudication or within such further period of time as the Federal or State law may permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy. * * *"

§ 70 of the Bankruptcy Act (52 Stat. 879, 881; 11 U. S. C. § 110):

"(c) * * * The trustee, as to all property in the possession or under the control of the bankrupt at

the date of bankruptcy or otherwise coming into the possession of the bankruptcy court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists; and, as to all other property, the trustee shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists." (In effect during the Alton bankruptcy proceeding; amended March 18, 1950, c. 70, § 2, 64 Stat. 23, and July 7, 1952, c. 579, § 23, 66 Stat. 429.)

Summary Statement

The basis for federal jurisdiction in the District Court was diversity of citizenship.

Petitioners herein sued representatively for a deficiency of $28,343,750 sustained upon Alton's liquidation in bankruptcy by holders of Alton bonds that had been secured by a first mortgage on all Alton's assets. The courts below granted summary judgment dismissing this action for all practical purposes, because not timely brought.

The defendant B. & O. became the owner of the entire capital stock of Alton in 1931 (5). It is charged with having thereafter, and until the approval of Alton's petition under Section 77 of the Bankruptcy Act (11 U. S. C. § 205) on November 25, 1942, dominated Alton completely and with having gradually milked Alton dry in its own interest, so that, by the time of Alton's bankruptcy, only a shell remained of the competent operating railroad, financed largely by the bondholders' investment, that the defendant

had taken over (5). The manner in which this was accomplished is set out specifically in paragraph "8" of the Consolidated and Amended Complaint herein (5-8).

Respondent served an answer in effect admitting Alton's complete subjection to B. & O., by its avowal that during the period in question "the Alton formed part of the system of railroads comprising the Baltimore & Ohio railroad system" (16).

The mortgage trustee for Alton's bondholders duly filed a blanket claim in their behalf in Alton's bankruptcy proceedings in the full face amount of $45,350,000. Such claim was duly allowed, with interest (10). The bankruptcy proceedings terminated on May 31, 1947, with the entry of a final order directing Alton's dissolution and yielding the bondholders about $375 for each $1,000 bond (37½¢ per $1), and leaving them with an aggregate deficit of $28,343,750 (12).

Such final order specifically preserved and reserved the rights of Alton's bondholders to assert their claims, if any, against B. & O., by directing that their bonds be perforated and stamped with the following legend (11-12):

> "This bond has been perforated and cancelled for all purposes except for purpose of evidencing right of the bearer or registered owner to a claim, if any, against the Baltimore & Ohio Railroad Company."

B. & O.'s wrongs to Alton were committed between 1931 and November 25, 1942, when Alton's petition in bankruptcy was filed and approved. Petitioners' action was commenced May 7, 1952, about five years after the final order in Alton's bankruptcy.

Reasons for Granting the Writ

A. The Decision of the Court of Appeals.

The Court of Appeals agreed with petitioners, and there was no substantial controversy below, in regard to the following propositions: (a) that under New York law judgment and execution returned unsatisfied, or their legal equivalents, are essential conditions precedent to the maintenance of a creditor's suit in aid of execution; (b) that no New York statute of limitations can commence to operate against such a suit until the creditor's claims have been brought into being by such return of process; (c) that where bankruptcy intervenes, a final order in a bankruptcy proceeding, determining that creditors cannot be paid in full from the assets of the principal debtor, is the legal equivalent of execution returned unsatisfied; and (d) that the only New York statute of limitations applicable to such a creditor's claim is the ten-year statute embodied in § 53 of the New York Civil Practice Act.

The Court of Appeals then, paradoxically enough, held (Appendix, p. 23), that petitioners' bill was "derivative, in effect", *i.e.*, "the plaintiffs stand in Alton's shoes; they have no shoes of their own"; that, hence, petitioners' claims against B. & O. were barred when Alton's were; that Alton's claims against B. & O. were governed by the New York three-year or six-year statute (N. Y. C. P. A. §§ 48, 49), and therefore "were not then [*i.e.*, when petitioners sued] available" to petitioners "because, before 1952, the statute of limitations had run with respect to those claims", viz., "Alton's claims against B. & O."

Hence, the legal pivot upon which this entire case turns is whether, under New York law, a plaintiff in a creditor's bill asserts a cause of action belonging to his principal debtor or a cause of action belonging independently to himself.

This action was initiated not only within ten years of the entry of the final order in Alton's bankruptcy, but also within ten years of the filing and approval of Alton's petition. It necessarily follows that if, under New York law, petitioners are asserting an independent cause of action for their own injury, this action was timely brought.

On the other hand, it may be conceded that if petitioners are suing derivatively in Alton's right, the claims asserted were outlawed by New York statute of limitation (New York Civil Practice Act §§ 48, 49) before petitioners' claims as execution creditors even arose.

B. The Impact of the Decision Below.

Directly, this action affects a large number of widely scattered investors holding $45,350,000 face value of first mortgage bonds of Alton. Indirectly, it affects investors everywhere in senior securities of American enterprises whose resources to meet their obligations to creditors cannot be measured, in the event of bankruptcy, until the conclusion of the reorganization process. It involves also, quite basically, aspects of the so-called "Deep Rock" doctrine enunciated by this Court in *Taylor* v. *Standard Gas & Electric Company,* 306 U. S. 307,—for the respondent B. & O., after acquiring all of Alton's voting stock, operated Alton as a mere instrumentality, in B. & O.'s sole interest, disregarding remediless bondholders whose senior contributions served largely to finance Alton's existence, to their injury in an amount exceeding $28,000,000.

By a clearly erroneous refusal to apply New York law, in violation of this Court's mandate in *Erie R. Co.* v. *Tompkins, supra,* and subsequent decisions, these bondholders have been denied all remedy.

Moreover, the decision of the Court of Appeals will be far reaching as a precedent.* The right of creditors, after

* In this connection see 56 Col. Law Rev. 106 (January 1956), where the case at bar has already been equated with a derivative stockholders' action.

judgment and execution or bankruptcy of the debtor, to pursue third persons whose wrongful acts or breaches of duty have contributed to the inability of the principal debtor to pay his debts, is one long recognized by courts of equity everywhere. By holding that such creditors sue in the right of their debtor, and are thus precluded by every defense available against their debtor, the Court of Appeals has drastically reduced and depleted the power of courts of equity and the rights of all execution creditors. For example, absent a specific enabling statute, the decision below, if logically applied, would preclude all creditors' actions to set aside fraudulent or illegal transfers; for, obviously, the transferor in such a transfer cannot recover from the transferee, and if the creditor sues derivatively, and asserts only rights of the transferor (his principal debtor), neither may the creditor.

C. The Decision Below Disregards New York Law Binding upon the Courts of the United States under the Doctrine of *Erie R. Co.* v. *Tompkins* and the Federal Constitution.

(a)

In holding that the plaintiffs in a creditor's bill stand in the shoes of their principal debtor and that their suit is "derivative, in effect", the Court of Appeals disregarded and refused to follow two controlling decisions of the New York Court of Appeals cited by the petitioners. These decisions are *Buttles* v. *Smith,* 281 N. Y. 226, decided in 1939, and *Hastings* v. *Byllesby,* 293 N. Y. 404, decided in 1944. In so doing, it invaded rights that this Court has held, in *Erie R. Co.* v. *Tompkins,* 304 U. S. 64, 79-80, and subsequent decisions, to be reserved by the Constitution to the State of New York.

In the *Buttles* case a corporation had paid the personal debt of an officer. The New York Court of Appeals held that a judgment creditor of the corporation with execution

"based, substantively, on one or more New York statutes" and by a footnote suggesting "that the instant case is analogous to *Byllesby* rather than *Buttles.*"

Plainly, no statute is relevant to the point here under discussion. The point of distinction made clear by the New York court was that, in the *Buttles* case, as here, the action was by a creditor in aid of execution and, hence, judgment and execution were conditions precedent to the existence of the cause of action and the operation against it of statutes of limitation; whereas the plaintiff in the *Byllesby* case, being the bankrupt's trustee in bankruptcy, truly stood in the shoes of the bankrupt and was governed by the same statutes of limitation as affected the bankrupt.

Since the petitioners here are *creditors,* whereas the plaintiff in the *Byllesby* case was a trustee in bankruptcy of the *debtor,* Judge Frank's footnote suggestion "that the instant case is analogous to *Byllesby* rather than *Buttles*" is incomprehensible.

The New York Court of Appeals held that the plaintiff in a creditor's bill stands in his own shoes and not the shoes of the principal debtor and sues for direct injury to himself and his fellow creditors, which injury cannot occur, and hence no cause of action can accrue, until judgment and execution determine that the creditor cannot be paid from the assets of the principal debtor. (See N. Y. C. P. A., § 11.)

To be sure, the acts of the B. & O. may have injured Alton when they were committed, just as payment of the officer's personal obligation injured the principal debtor in the *Buttles* case. But such acts did not injure the bondholders, according to the above New York cases, until entry of the final order in the Alton bankruptcy proceeding determined that they had in fact been injured thereby. Nor is there anything unusual about the proposition that a single wrongful act or breach of duty may injure different people

at different times and give rise to different causes of action covered by separate and different statutes of limitation.

> "The single wrongful act which is asserted as the basis of recovery may constitute the breach of a number of obligations of diverse nature and origin.
>
> * * *
>
> "Each so-called 'separate and distinct cause of action' becomes in effect a 'count' in the allegation of a single wrong; and whether the statute (of limitations) bars recovery under any count depends upon the nature and origin of the liability asserted in that count".
>
> *Schmidt* v. *Merchants Despatch Transp. Co.*, 270 N. Y. 287, at page 299.

The "nature and origin" of the liability asserted here by the petitioners differs in amount and date of incidence from any claim Alton may have had against B. & O. Regardless of the extent of Alton's damage, petitioners may recover only the deficiency the bondholders as a class sustained when the bankruptcy court wound up Alton's affairs; and only then was it determinable that they had any claim at all against B. & O.

A further settled principle of New York law that the Court below disregarded emphasizes the error of its decision. In New York, statutes of limitation such as are here involved have been held to affect merely the remedy, not the right. In *Hulbert* v. *Clark*, 128 N. Y. 295, the rule was stated as follows (at p. 297):

> "The statute of limitations does not after the prescribed period destroy, discharge or pay the debt, but it simply bars a remedy thereon. The debt and the obligation to pay the same remains, and the arbitrary bar of the statute alone stands in the way of the creditor seeking to compel payment."

Even if it be reasoned that this creditors' suit seeks not to recover for injury to the bondholders caused by the wrongful acts of B. & O., but to subject an asset of Alton to petitioners' execution and that such asset is Alton's claim against B. & O., the result under New York law is the same. The claim remains, though three or six year statutes of limitation may operate to prevent maintenance of an action upon it by Alton or one suing in Alton's shoes, *i.e.*, derivatively. It does not follow from the fact that Alton may not sue that petitioners, as execution creditors of Alton, cannot apply so much of such claim as may be necessary to satisfy their deficiency. Since under New York law the claim continues to exist, these petitioners, having sued within ten years of the accrual of their claims under New York law, have proceeded timely against B. & O.

The *Buttles* case so held on its facts, *i.e.*, it permitted an action on behalf of the execution creditor to be maintained eleven years after the wrongful act was done and hence long after the principal debtor was precluded from initiating an action to recover the misappropriated funds.

The Courts below have in effect held that the plaintiff-bondholders' claim against the defendant might be barred by limitations before New York law gave them standing to sue. Even the most foreshortened statutes of limitation are not designed so to preclude redress to those without standing in law, and accordingly helpless, earlier to defend their rights. The decisions below are, petitioners believe, unique in their outlawry of a claim before its accrual under the settled law of the State in which an action based on diversity jurisdiction is brought.

(b)

Although we deem them logically entirely immaterial, brief mention should perhaps be made of three other statements in the opinion of the Court of Appeals which we

believe demonstrate that Court's lack of appreciation of the sharp question here involved.

1. In his opinion Judge Frank refers to what he terms the "harsh and inequitable" New York rule that statutes of limitation continued to operate prior to the bankruptcy, while Alton was "virtually B. & O.'s slave".

In the first place, we think the Court of Appeals erred in respect of the law. We believe the New York rule to be that the statute runs so long as anyone exists who is empowered to assert the particular cause of action. In every case cited, or which we can find, there were minority stockholders who could have acted. A careful search discloses no case holding that statutes of limitation operate during periods of 100% stock ownership of the victim by the wrongdoer, as here; and we suggest that, if the question were squarely presented, the New York courts would hold that the statute is tolled so long as there is no one empowered to prosecute the action. Certainly there is no New York ruling to the contrary. In fact, the New York courts have not hesitated to deny a wrongdoing defendant the benefit of the statute of limitations where such defendant is responsible for the failure to prosecute in time a claim against him. *Dodds* v. *McColgan,* 229 App. Div. 273; *Safrin* v. *Friedman,* 96 N. Y. S. 2d 627, aff'd 277 App. Div. 1138; *In re Meyrowitz' Estate,* 114 N. Y. S. 2d 541, 547 (not officially reported). It is significant that in this line of cases the New York courts relied on no statute, but on the inherent powers of courts of equity to prevent a miscarriage of justice.

However, determination of this question is wholly unnecessary. If, as the Court of Appeals held, this action is derivative, the cause of action was outlawed long before this action was commenced, even if the statute was suspended until November 1942, because Alton's cause of action would be governed by the three or six year statute,

and more than six years elapsed between the appointment of Alton's bankruptcy trustee—who certainly could have asserted any cause of action belonging to Alton—and the commencement of this action. On the other hand, if, as petitioners contend, this creditors' suit is not derivative but is direct, and seeks recovery for injury to the bondholders and not to Alton, it was certainly timely brought, since it was commenced within ten years of the date when it accrued.

2. The Court of Appeals also suggested that the cause of action asserted in the complaint herein could have been maintained by Alton's trustee in bankruptcy.

Of course, if the claims here asserted are derivative, they could have been asserted by the trustee and, as aforesaid, were outlawed long before this action was commenced.

Perhaps Judge Frank had § 70 of the Bankruptcy Act (52 Stat. 879, 881; 11 U. S. C. 110) in mind, providing that the trustee "shall be deemed vested as of [the date of bankruptcy] with all the rights, remedies and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists". This portion of the Act has been held limited to recovery of fraudulent conveyances and preferences; see *In re Jacoby*, 138 F. (2d) 42; *Courtney* v. *Georger*, 228 Fed. 859, cert. den. 241 U. S. 660; and, of course, the New York Court of Appeals so held in the *Byllesby* case.

Incidentally, attention is called to the fact that this statute conclusively demonstrates that Congress when it framed the Bankruptcy Act recognized the distinction that petitioners have so unsuccessfully urged upon the courts below. If an execution creditor claims in the right of his principal debtor, there was no conceivable reason for the above provision. Its presence in the Bankruptcy Act shows that Congress realized that an execution creditor has rights other and greater than those of the bankrupt; *e. g.*, the de-

fendant may not set up defenses—such as estoppels of various kinds, illegality, or short statutes of limitation—which would be available in any suit by or in the right of the bankrupt.

In any event, however, whether or not the bankruptcy trustee could assert a cause of action as though he were a judgment creditor with execution returned unsatisfied is immaterial. This action was instituted within ten years of "the date of bankruptcy", the date as of which the statute vests the trustee with whatever rights he may have. The petition in the Alton bankruptcy was filed and approved November 25, 1942; this action was commenced May 7, 1952, within the ten-year period applicable to creditors' bills. No one can contend that anyone was in existence prior to November 25, 1942, empowered to assert the claims of a judgment creditor with execution returned unsatisfied.

3. The opinion below puts in the petitioners' mouths the "contention that the statute commences to run anew when a claim passes to an assignee of, or successor to, one who could have sued thereon" (58). Petitioners of course made no such contention. This misconception of petitioners' position further accentuates the basic error upon which the Court below proceeded.

Hence, we repeat, the entire case turns upon whether the Court of Appeals correctly decided that a judgment creditor's suit is secondary. If, as we contend, the New York courts have conclusively determined that it is primary, seeks recovery for direct injury to the creditors, and comes into existence only when execution, or the equivalent thereof, is returned unsatisfied, the Court of Appeals is bound by such determination, this action was timely brought, and the Court of Appeals erred in failing and refusing to apply the New York rule.

(c)

In conclusion, we point out that the New York rule for which petitioners contend is in line with sound public policy. Until judgment and execution, the creditor is helpless; he has no cause of action. As here, the defendant may control the principal debtor; they may be in actual collusion; they may have other mutual interests which preclude or discourage action by the principal debtor; the principal debtor may be merely careless and lethargic or loath to litigate. There may be many reasons why the principal debtor fails or refuses to act while the statute runs against him. Such statute may be a short one (there is cogency in B. & O.'s contention below that the three-year statute applied to any claim against it by Alton), or it may be near expiration when the principal debtor's obligation to his creditor first falls due. In the instant case, if the three-year statute applied to any claim by Alton, such period had run its full course before the bondholders had any cause of action; if the six-year statute applied, it was complete, as Judge Frank pointed out, on November 25, 1948, eighteen months after petitioners' cause of action accrued. In many, if not most, cases it would be literally impossible for a creditor to litigate and secure his judgment and execution against the principal debtor and institute his creditor's bill against the defendant before the statute barred his principal debtor's claim. As between the injustice of denying all relief to a helpless though vigilant creditor and the suggestion that early repose is desirable, the equities and dictates of sound public policy favor the rule for which petitioners here contend.

No doubt these considerations were included in the reasons underlying the rule laid down by the New York courts, *i. e.*, that an execution creditor suing a third person for a wrong or breach of duty to his principal debtor does not assert a cause of action belonging to the principal

debtor but stands in his own shoes and sues for injury to himself and his fellow creditors, upon a claim that does not accrue, and thus cannot be affected by any statute of limitations, until the return of execution unsatisfied.

Conclusion

Wherefore, petitioners pray that this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit be granted.

Dated: New York, February 15, 1956.

Respectfully submitted,

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